

JAN 25 1999

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Index (UIL) No.: 461.08-01
CASE MIS No.: CC:DOM:IT&A:5 - TAM-118036-98

District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

LEGEND:

Defendant =

State A =

State A statute =

Natural Disaster =

year 1 =

year 2 =

year 3 =

year 4 =

\$a =\$b =

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ISSUE(S):

Whether the Taxpayer must include in income in year 3 the post-judgment interest due on the punitive damage portion of its judgment, where the judgment became final and non-appealable in year 3?

CONCLUSION:

The Taxpayer must include in income in year 3 the post-judgment interest due on the punitive damage portion of its judgment.

FACTS:

Taxpayer owned certain business property in State A, which was damaged by a Natural Disaster in year 1. Taxpayer had an insurance policy with the defendant that insured against the Natural Disaster loss. The defendant refused to pay for the damages, and the Taxpayer sued the defendant in State A court for breach of contract, negligence, and bad faith failure to pay insurance benefits. The Taxpayer also sued the insurance agent for negligence in connection with the policy and the claim.

A jury awarded the Taxpayer \$a in actual damages against the defendant and the agent and \$b in punitive damages against the defendant, only. A corresponding judgment was entered in year 2. The judgment did not mention post-judgment interest; however, the issue was raised in post-trial motions. Thereafter, the defendant and the agent unsuccessfully appealed the judgment to the Supreme Court of State A. The defendant also filed a petition for writ of certiorari with the United States Supreme Court. The issue of whether the defendant owed post-judgment interest on the punitive damage portion of its judgment was raised, but not pursued, on appeal.

After the judgment was affirmed by the State A Supreme Court and prior to the defendant having filed a petition for writ of certiorari with the United States Supreme Court, the clerk of the State A court notified the defendant of its obligation to pay post-judgment interest. The notice was sent to the defendant pursuant to the State A statute which provides that "[a]ll money decrees and judgments of courts enrolled or entered **shall** draw interest according to law. The legal interest rate shall be at the rate of fourteen percent per annum."(emphasis added)

In year 3, the agent paid the actual damage portion of the judgment, with interest, and the defendant's petition for writ of certiorari was denied. Also in year 3, the defendant paid the punitive damage portion of the judgment, but refused to pay interest thereon. The defendant contested its liability for the interest and sought the assistance of the State A trial court. The Taxpayer argued that the State A statute requires the payment of post-judgment interest on all judgments, that post-judgment interest is mandatory and that the court has no discretion. The State A court, while

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refusing to issue an advisory opinion, stated that "there is no explanation as to why [the defendant] thinks it is exempt from the operation of the statute or why this issue was raised, but not pursued, in the previous appeals that went all the way to the Supreme Court of the United States." Ultimately, in year 4, the defendant paid the interest in full.

The Taxpayer is an accrual basis taxpayer, and in year 4, elected subchapter S status. On its original year 3 corporate tax return the Taxpayer properly included in income the interest on the actual damage portion of the judgment, but failed to include in income both its punitive damage award and the interest thereon. Thereafter, the Taxpayer filed an amended year 3 corporate tax return which included in income the punitive damages award, but not the interest accrued thereon through the end of year 3.

LAW AND ANALYSIS:

This request for technical advice concerns the timing of the post-judgment interest income on the punitive damage portion of the Taxpayer's judgment. There is no dispute that the judgment became final and non-appealable in year 3. The agent argues that interest on the punitive damage portion of the judgment should be included in income in year 3, to the extent it has accrued. In contrast, the Taxpayer argues that because the liability for the interest was disputed until year 4, it should not be included in income in year 3. The Taxpayer argues that the "all event test" requires the acknowledgment of the liability by the defendant before the right to the income is fixed. Taxpayer also argues that the amount of the interest cannot be determined with reasonable accuracy.

Section 451(a) of the Code governs the year in which income must be included and provides that "[t]he amount of any item of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period." Section 1.451-1(a) of the regulations provides, that under an accrual method of accounting, income is includible when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

Fixed right to receive income

All the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due or (3) payment is made, whichever happens first. See Schlude v. Commissioner, 372 U.S. 128 (1963); Rev. Rul. 84-31, 1984-1 C.B. 127; Rev. Rul. 83-163, 1983-2 C.B. 26; Rev. Rul. 83-106, 1983-2 C.B. 77. The issue here is whether the payment of interest on the punitive damage portion of the judgment was due in year 3. "[I]t is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income." Spring City Co. v.

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Commissioner, 292 U.S. 182, 184 (1934); Commissioner v. Hansen, 360 U.S. 446 (1959). Income from disputed obligations is not properly accruable until the dispute is resolved. Continental Tie & Lumber Co. v. United States, 286 U.S. 290 (1932). Generally, a dispute is resolved when either the liability is acknowledged by the obligor, or the liability is finally determined by the court and is not subject to further appeal. See United States v. Consolidated Edison Co., 36 U.S. 380, 386-387, reh'g denied, 368 U.S. 884 (1961); Dixie Pine Co. v. Commissioner, 320 U.S. 516, 519 (1944). The Taxpayer, in the present case, agrees that the judgment became final and non-appealable in year 3 and that the defendant raised, but did not pursue, the post-judgment interest issue on appeal.

The Taxpayer argues that even though the underlying judgment was final, its right to receive interest on the punitive damage portion of the judgment was not fixed until year 4. The Taxpayer claims that its right to the interest does not become fixed until either the defendant admitted its liability for the interest¹ or until the interest issue is resolved in a subsequent collection action. The agent takes the position that the Taxpayer's right to interest is fixed once the underlying judgment becomes final. We agree with the agent's position.

The State A statute providing for the post-judgment interest is mandatory (all judgments² shall draw interest) and is not subject to judicial discretion. See Sears v.

¹ Taxpayer cites United States v. Safety Car Heating & Lighting Co., 297 U.S. 88 (1935) as the leading authority for the proposition that the income is not fixed until the defendant admits its liability. In that case, the taxpayer filed a patent infringement suit. Judgment had been entered against the infringer and cross-appeals were filed. The taxpayer asserted that the judgment was too small, the infringer asserted that it was too great. While the appeal was pending the parties settled the suit. The Court acknowledged that while the appeal was pending the taxpayer's claim was disputed and inchoate. However, once the settlement was approved the court, the taxpayer's claim amounted to something more than a claim... "[i]t was income fully-accrued and taxable as such." Under the holding of this case, income also would have accrued if, as in this case, a final non-appealable decision had been entered.

² Unlike the position it took in the underlying litigation (that the statute is mandatory and applied to all judgments), the Taxpayer, here, suggests that the applicability of the statute to the punitive damage portion of the judgment is and was uncertain. The language of the statute, however, is clear and unambiguous and requires the payment of post-judgment interest on **all judgments**. It makes no distinction whatsoever on the underlying basis of the judgment. Moreover, the purpose of the statute is to encourage judgment debtors to pay their judgments promptly. Casey v. Casey, 311 S.C. 243, 428 S.E.2d 714 (1993). This purpose is equally, if not more, applicable to judgment debtor's found liable for punitive damages.

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Fowler, 293 S.C. 43, 358 S.E.2d 574 (1987); Turner Coleman, Inc. v. Ohio Constr. & Engineering, Inc., 272 S.C. 89, 251 S.E.2d 738 (1979). Moreover, courts interpreting a similar federal statute, 28 U.S.C. § 1961(a),³ have held that "[i]nterest accrues from the date of the judgment whether or not the judgment expressly includes it, because 'such interest follows as a legal incident from the statute providing for it.'" Waggoner v. R. McGray, Inc., 743 F.2d 643, 644 (9th Cir. 1984) (quoting Blair v. Durham, 139 F.2d 260, 261(6th Cir. 1943)). See also Tinsley v. Sea-Land Corp., 979 F.2d 1382 (9th Cir. 1992). In addition, once a final judgment has been entered in a civil suit in federal court, the prevailing party becomes entitled to post-judgment interest under the mandatory terms of 28 U.S.C. § 1961, regardless of whether the judgment itself contains a specific award of interest. U.S. v. Michael Schiavone & Sons Inc., 450 F.2d 875, 876 (1st Cir. 1971). Post judgment interest is a creature of statute not subject to judicial modification. Williamsburg Wax Museum, Inc. v. Historic Figures, Inc., 810 F.2d 243 (D.C. Cir. 1987). Given the mandatory terms of the State A statute (all judgments shall draw interest) and the fact that it too is not subject to judicial discretion, the Taxpayer's right to post-judgment interest became fixed on the date the judgment became final.

Amount is reasonably determinate

The Taxpayer argues that the amount of interest to which it was entitled could not reasonably be determined in year 3. It takes this position because the defendant contested its liability for the interest, and until it was paid, the amount was subject to compromise. Given our finding that the Taxpayer's right to the interest was fixed when the underlying judgment became final, we further find that the amount of interest is readily determinable. The statute provides for interest at the rate of 14% per annum. It accrues from the time the judgment is entered until the time it is paid. If the amount of interest owed was subsequently compromised, a possibility suggested by the Taxpayer, then the Taxpayer may be entitled to a corresponding deduction. See Meyer v. Commissioner, 547 F.2d 943 (5th Cir. 1977); Iowa Southern Utilities Co. v. United States, 348 F.2d 492, 172 Ct. Cl. 21 (1965).

Having determined that the Taxpayer's right to the post-judgment interest on the punitive damage portion of its judgment was fixed in year 3 and that the amount of the accrued interest was reasonably determinable at that time, we find that it must be included in the Taxpayer's income in year 3.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

³ Section 1961 provides that "[i]nterest shall be allowed on any money judgment in a civil case recovered in a district court..."